

May 7, 2019

FOR YOUR INFORMATION

To: Mayor and Members of Council
From: Patrick A. Duhaney, City Manager *PA*
Subject: Impact of Property Tax Incentives on CPS Revenue

Overview

City property tax incentives impact the revenue received by the City School District of the City of Cincinnati ("CPS") at both the local level and at the state level. This memorandum provides an explanation of the estimated impacts of property tax incentives on CPS's local and state revenue and further details other non-quantifiable benefits that accrue to CPS from incentivizing development. Finally, this memorandum explains some of the City's alternatives under state law should the City and CPS not reach an omnibus agreement on property tax incentives.

Property Tax Incentives Increase CPS Revenue

For purposes of CPS revenue, there are three primary categories of funding sources that are impacted by property tax incentives: (1) local property tax revenue, (2) State of Ohio funding, and (3) payments in lieu of taxes ("PILOTs"). Property tax incentives operate by abating or re-directing property tax revenues, so these incentives impact CPS's local property tax revenue; however, property tax incentives also impact revenue CPS receives from the State of Ohio and provide CPS with a new source of revenue through PILOTs. City analysis of the impact of property tax incentives on these three funding sources concludes that incentives actually increase CPS's overall revenue.

Local Revenue Impacts

CPS derives about 45% of its annual funding from local property tax collections. Under its current levy structure, CPS receives half of its local property tax revenue from fixed-sum levies and the other half from fixed-rate levies. Fixed-sum levies operate in a similar way to the City's property tax rollback, in that the levies raise a certain set sum of revenue, and the levy millage is reset annually based upon the available tax base. As a result, property tax incentives have no impact on approximately half of CPS's local revenue, since the revenue amount does not change.

Fixed-rate levies operate by applying a set millage amount to the available tax base. Since property tax incentives reduce the amount of property value subject to taxation, property tax incentives decrease CPS revenue under the fixed-rate levies.

In order to calculate foregone revenue of CPS under the fixed-rate levies, you must multiply the effective tax rate¹ of their fixed-rate levies with the abated property value.

¹ For the purposes of this memorandum, all references are to TY 2018 commercial millage and tax rates. CPS TY 2018 fixed-rate millage is 31.94. The effective tax rate is calculated by dividing the applicable millage by 1000 and multiplying by 35%.

Example²: CPS TY 2018 Fixed-Rate Effective Tax Rate = 1.12%

$\$1 \text{ Million Abated Value} \times 1.12\% = \$11,200$

The impact on CPS local tax revenue is an annual \$11,200 reduction.

City Requires Cash Payments to CPS

Pursuant to the Agreement entered into in 1999 between the City and CPS (the “1999 Agreement”), the City requires recipients of covered property tax incentives to make cash payments to CPS in the form of PILOTs. PILOTs are payments made to CPS in lieu of tax revenues that CPS would have otherwise received without an incentive in place. PILOTs create a new local revenue source for CPS. Under the 1999 Agreement, the City requires 25% PILOT payments,³ which equal 25% of the total tax revenue generated from the abatement.⁴ The actual dollar amount of the PILOT payments is determined by the overall effective tax rate.

Example: TY 2018 Effective Commercial Tax Rate = 3.4%

Step 1: $\$1 \text{ Million Abated Value} \times 3.4\% = \$34,000$

Step 2: $\$34,000 \times 25\% = \$8,500$

CPS receives an annual \$8,500 PILOT.

State Revenue Benefit to CPS Directly Resulting from City Incentives

The State of Ohio distributes funding to local school districts based on a complex formula that accounts for many variables, including several variables that are meant to measure the overall wealth of the district. One important variable is the aggregate assessed property value within the district. Generally, if the assessed property value in a district increases, then the State’s funding to CPS decreases. The assumption underlying this result is that since the aggregate assessed property value in the district has risen, then the school district will be receiving additional local revenue and will require less revenue from the State.⁵ Property tax incentives impact the level of state funding by preventing an increase in the aggregate assessed property value, which in turn prevents a decrease in the State’s funding.

An abatement of \$1 million in property value creates an effective increase in State of Ohio funding to CPS of \$9,800 annually.⁶

Net Revenue Impact

When accounting for local and state revenue impacts, overall CPS revenue increases due to property tax incentives.

² Note that calculations herein are rounded for demonstration purposes.

³ There are some exceptions to the requirement for 25% PILOT payments in the 1999 Agreement. Further, in relation to tax increment financing districts, the required PILOT amount is 27%.

⁴ Note that in the context of commercial community reinvestment area exemptions, the abatements do not actually generate other revenue; instead the property owner is required to make the PILOT payment directly to CPS.

⁵ It should also be noted that CPS’s reliance on fixed-sum levies diminishes their ability to raise additional local tax revenue from increasing property values.

⁶ This estimate is based on the City’s analysis of the current state funding formula and utilizing data as of 12/31/2018.

Calculation with Incentive: PILOT plus State Funding Effective Increase less Local Revenue Decrease

$$\$8,500 + \$9,800 - \$11,200 = \$7,100 \text{ Net Increase in CPS Revenue with Incentive}$$

Calculation without Incentive: Local Revenue less State Funding Decrease

$$\$11,200 - \$9,800 = \$1,400 \text{ Net CPS Revenue without Incentive}$$

In the context of the \$1 million abatement example, the incentive increases CPS annual net revenue from \$1,400 to \$8,500, an approximately 500% annual increase totaling \$7,100.

In order to simply break even with the revenue that CPS otherwise would have received, the appropriate annual PILOT amount for CPS would be approximately 5% on a 30-year incentive.⁷

In order to assess the historic revenue impacts of the City's incentive programs, the City conducted an aggregate analysis of tax years 2012-2018. This analysis estimates the annual net revenue impacts to CPS of the City's incentive programs, including residential incentive programs. A summary of those findings is attached as Attachment A.

Additional Beneficial Factors

The above calculation does not account for multiple additional factors that positively impact CPS but are more difficult to quantify.

First, there is no basis to assume that every single project that received a property tax incentive would have otherwise occurred without the incentive. The very purpose of the City's property tax incentive program is to attract development that would not otherwise occur in the City and increase private investment in our built environment. Incentives operate as public investments that leverage private investment, and the City's property tax incentive programs are critical to encouraging developers to take on risky, expensive, and difficult projects. The City's historic building stock is a tremendous asset, but redeveloping these aging structures is costly. Property tax incentives attract continued private investment, which, as with any physical asset, is necessary in order to defend against disinvestment and the ultimate decline of the built environment. Without the City's property tax incentive programs most of the development that has occurred in recent years would not have happened, and City neighborhoods, and by connection the underlying tax base relied upon by CPS, would not be the communal assets that they are today.

Property tax incentives are particularly important given the challenges of urban redevelopment and the numerous alternative competing development opportunities in our region and country. For years the City experienced outward migration to suburban jurisdictions, which offer far cheaper and easier development opportunities. Only in recent years has the City been able to reverse these negative trends by providing developers with incentives to tackle the challenges of urban redevelopment and complex, costly renovation and construction projects.

⁷ This PILOT amount is generated by estimating the aggregate net revenue to CPS over a thirty-year period if an exemption was not in place, accounting for local and state revenue impacts, then setting the PILOT amount so the PILOT revenue is equal to the estimated aggregate revenue. The calculation for the annual break-even PILOT amount in the herein discussed example is $\$1,400/\$34,000 = 4.12\%$. The City estimate of 5% incorporates a phasing in of the increase to the assessed property value under the State's funding formula.

Finally, the above calculation does not account for the beneficial impacts that new development has on proximate properties. The granting of a property tax incentive is a public investment not just in the project but in the neighborhood where the development occurs. The benefits ripple out beyond the project site and increase the health of the real estate market in that area and encourage further private investment. All of this in turn generates additional revenue for CPS.

City Alternatives to Agreement

A collaborative agreement with CPS regarding property tax incentives would be beneficial to both parties; however, if the parties are unable to agree on terms, the City can continue to incentivize development, but programmatic changes will be required. The two primary incentive programs that will be affected are the City's commercial community reinvestment area ("CRA") program and the City's tax increment financing ("TIF") program.

Without an agreement in place with CPS, the City could still offer a 50% 15-year commercial CRA abatement. The City's residential CRA program would not be negatively impacted. However, if the parties do not reach an agreement, the City may choose to expand its residential CRA program to include multi-unit residential developments in excess of three units. Currently, larger residential projects fall within the City's commercial CRA program; however, state law permits the City to dictate whether multi-unit residential projects fall within the commercial or residential CRA program. This programmatic change could be done without the approval of CPS. Also note that if multi-unit residential projects become part of the residential CRA program, there would be no required PILOT payments to CPS associated with such abatements.

Without CPS approval, the City can offer a 75% 10-year TIF abatement or, alternatively, a 100% 30-year TIF abatement, provided that CPS is compensated for any reduction in overall tax revenues. Given the herein discussed revenue impacts, this approach could allow the City to grant 30-year 100% abatements at a PILOT amount significantly less than the 25% PILOT payment established under the 1999 Agreement.

The City could also explore restructuring its urban renewal program, which would permit a 75% abatement without school district approval for as long as needed to repay debt associated with the project.

If these programmatic changes were put into place, CPS would see revenue reductions in comparison to the revenue generated for CPS under the terms of the 1999 Agreement. For example, for a \$1 million abatement, when accounting for state and local revenue impacts, CPS would only receive an estimated \$350 dollar annual increase in revenue for the first ten years of a 75% 10-year TIF incentive;⁸ however, under a 100% 30-year abatement with a 25% PILOT, CPS receives an estimated \$8,500 per year. The loss of commercial CRA PILOT payments for multi-unit residential projects would also significantly decrease CPS revenue.

Conclusion

Continued economic growth is critical to a healthy and thriving City and school system. As evidenced here, by incentivizing growth in accordance with the 1999 Agreement, CPS has seen an increase in its revenues that it would not have otherwise realized.

⁸ Note that Ohio Revised Code 5709.82 at times requires that a municipality that grants certain exemptions without a school district agreement in place must share a portion of income taxes resulting from the project exemption with a school district; however, this requirement would not be applicable to the vast majority of projects and so is not factored into this calculation.

Without an agreement, the City will still be able to offer property tax incentives to assist development projects that would not otherwise occur in the City, but the City will have to restructure its incentive programs. For CPS, having no agreement in place will have a significant negative impact on CPS revenues.

As the end of the 1999 Agreement draws near, the City Administration has had discussions with CPS Administration to discuss possible terms for a new agreement. Unfortunately, CPS leadership discontinued these discussions. Reaching an agreement regarding property tax incentives is the most advantageous outcome for both the City and CPS, so the City Administration remains willing to reengage with CPS staff to find a collaborative solution.

Attachment

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Attachment A

Commercial Incentive Programs									
Tax Year	Est. TIF Abated Value	Est. Commercial CRA Abated Value	Total Est. Abated Value	Estimated CPS	Effective State	Estimated			
				PILOT Revenue With Abatement (a)*	Funding Formula CPS Increase**(b)	Foregone CPS Property Tax Revenue (c)	Net Increase in Revenue with Abatement (a+b+c)	% Increase	
2012	\$ 896,858,400	\$ 634,539,800	\$1,531,398,200	\$ 11,353,053	\$ 11,900,000	\$ (16,983,508)	\$ 6,269,545	123%	
2013	\$ 1,120,742,570	\$ 663,533,190	\$1,784,275,760	\$ 13,311,192	\$ 13,500,000	\$ (19,953,413)	\$ 6,857,779	106%	
2014	\$ 1,219,767,080	\$ 610,633,170	\$1,830,400,250	\$ 13,744,557	\$ 13,800,000	\$ (20,864,129)	\$ 6,680,428	95%	
2015	\$ 1,305,188,980	\$ 614,824,870	\$1,920,013,850	\$ 14,231,311	\$ 14,400,000	\$ (21,988,548)	\$ 6,642,764	88%	
2016	\$ 1,259,264,700	\$ 861,164,290	\$2,120,428,990	\$ 17,215,357	\$ 15,600,000	\$ (24,340,209)	\$ 8,475,148	97%	
2017	\$ 1,672,153,700	\$ 1,118,648,480	\$2,790,802,180	\$ 21,412,274	\$ 19,700,000	\$ (30,988,103)	\$ 10,124,170	90%	
2018	\$ 1,805,730,680	\$ 1,267,754,570	\$3,073,485,250	\$ 23,507,611	\$ 21,500,000	\$ (34,358,398)	\$ 10,649,213	83%	

Commercial and Residential Incentive Programs									
Tax Year	Est. TIF Abated Value	Est. Commercial and Residential CRA Abated Value	Total Est. Abated Value	Estimated CPS	Effective State	Estimated			
				PILOT Revenue With Abatement (a)*	Funding Formula CPS Increase**(b)	Foregone CPS Property Tax Revenue (c)	Net Increase in Revenue with Abatement (a+b+c)	% Increase	
2012	\$ 896,858,400	\$ 1,299,831,950	\$2,196,690,350	\$ 11,353,053	\$ 16,100,000	\$ (22,382,829)	\$ 5,070,224	81%	
2013	\$ 1,120,742,570	\$ 1,344,946,190	\$2,465,688,760	\$ 13,311,192	\$ 17,700,000	\$ (25,518,026)	\$ 5,493,166	70%	
2014	\$ 1,219,767,080	\$ 1,309,107,620	\$2,528,874,700	\$ 13,744,557	\$ 18,100,000	\$ (26,525,613)	\$ 5,318,944	63%	
2015	\$ 1,305,188,980	\$ 1,298,133,960	\$2,603,322,940	\$ 14,231,311	\$ 18,600,000	\$ (27,945,097)	\$ 4,886,215	52%	
2016	\$ 1,259,264,700	\$ 1,577,715,480	\$2,836,980,180	\$ 17,215,357	\$ 20,080,000	\$ (30,179,819)	\$ 7,115,538	70%	
2017	\$ 1,672,153,700	\$ 1,906,081,517	\$3,578,235,217	\$ 21,412,274	\$ 24,600,000	\$ (37,097,490)	\$ 8,914,784	71%	
2018	\$ 1,805,730,680	\$ 2,069,926,287	\$3,875,656,967	\$ 23,507,611	\$ 26,400,000	\$ (40,595,983)	\$ 9,311,627	66%	

*PILOT amounts based on City payments to CPS related to TIFs and 25% PILOTs on est. commercial CRA abatements. City 2018 payment estimated.

**Amounts are City's best estimate based on the current State funding formula and data. Amount shown is the estimated amount that would be deducted from CPS State funding without abatement in place.